

June 8, 1994

LETTER 1149

THE REALLY BIG PICTURE: It's that the Fed and the Treasury are in a very weak position to defend the dollar -- and what's more, every FOREX (foreign exchange) trader is aware of it.

Consider this -- the latest poll shows Clinton's "approval rating" dropping to a very low 42%. Remember Clinton's election slogan, "It's the economy, stupid"? Well, it's still the stupid economy -- and Clinton knows it, every Democrat knows it, and the Fed knows it. And oh yes, there's an election coming up in the fall.

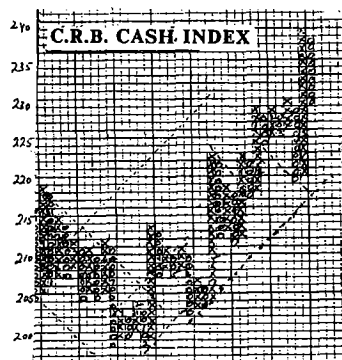
As to the economy, Clinton's action on the Chinese "Most Favored Nation" situation said it all. When it comes to economics vs. Clinton's expressed policy, economics wins hands-down.

NEW YORK — He capitulated to the Chinese, compromised with the Japanese and confronted the British.

In all three instances this past week, President Clinton struck a common theme: In a global economy, U.S. business profits and American jobs take priority in his administration's foreign policy considerations.

Making one of the biggest political retreats in the American relationship with China, Clinton renewed that country's preferential trading status with practically no conditions.

In so doing, Clinton essentially abandoned an earlier pledge to punish the Chinese government with trade



The news on the economy is that it's slowing down, this in the face of the rising trends in the CRB Commodities Futures Index and the Raw Materials Index. It's the ideal prescription for "stagflation."

Nation's Economic Growth Slows Down; Further Slack Ahead

By JAMES H. RUBIN
Associated Press Writer

WASHINGTON — Economic growth slowed dramatically in the first quarter of 1994 because of winter storms and the California earthquake, but remained stronger than anticipated.

The Commerce Department said the economy expanded at a healthy 3 percent annual rate -- down from the booming 7 percent rate for the final three months of 1993 but more rapidly than the government estimated a month ago.

Fed's Chairman Defends Interest Rate Increases

By DAVE SKIDMORE
Associated Press Writer

WASHINGTON — The Federal Reserve had to raise interest rates this year to avoid an outbreak of inflation that could have endangered the expanding economy, Chairman Alan Greenspan said.

Greenspan, appearing before the Senate Banking Committee, vigorously defended the central bank's decision to increase short-term interest rates four times since February.

He said that the Fed had held rates at unusually low levels through the end of 1993 to ensure a good start to the economic recovery.

The Fed has its problems as well. Almost daily Greenspan has been called upon to defend the Fed's action in boosting interest rates four times in succession. And the unkindest cut, economists are accusing the Fed of trying to "kill the upturn."

May 27 DJIA 3757.14; PTI 4015; A-D Ratio -5.68
June 3 DJIA 3772.22; PTI 4022; A-D Ratio -5.33
Dow Yield: 2.68%; Dow Price/Earnings: 25.4
Dow 200-day MA: 3731; Dow 30-day MA: 3710
Dow Times Book Value: 3.29; PTI 89-day MA: 4032
Percentage of Undervalued Blue-chips: 12%
Dow Low Risk Buy Index: -45; Gold-PTI: 918
Gold 40-week MA: 378

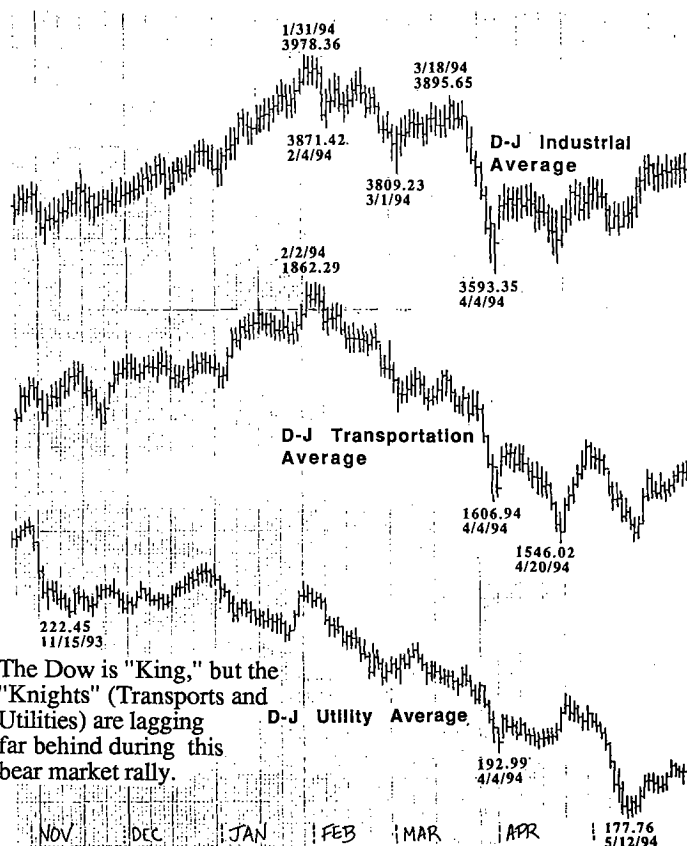
At my end, I've had a few very interesting developments, namely "Low-Risk Buy" signals on the dollar (that's right, the dollar), on the Dow, on the Utilities and on the large commercial banks. All of which suggests that this is "respite time" for a number of previously weak markets.

So watch for strength in the above areas, at least for a while. The bear has had his initial inning, now he evidently wants a "rest." Market rallies will undoubtedly stir up cries of "the bull is returning, the bull is returning." Don't believe it -- to repeat, the bear is only resting.

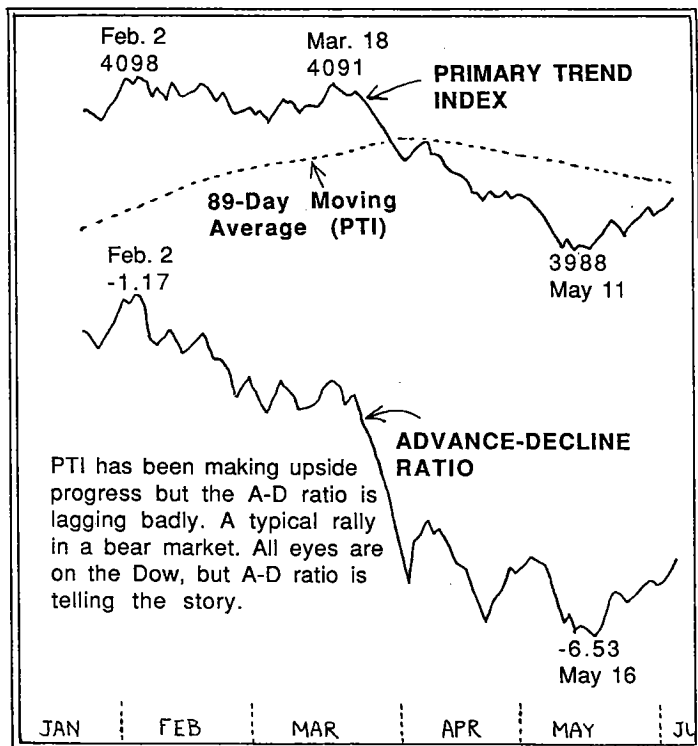
Despite Dow strength, the Transports are dragging their feet. A new Dow high unconfirmed by Transports? Not likely, but where the market's concerned, "anything's possible."

THE MARKET: We've had our first down-leg in the bear market, and it wasn't that terrible (except for the Utilities and bonds and a few hundred selected stocks). So now what? Here's what I think.

I believe the stock market is currently "stuck" in a sort of frustrating "no-man's land." Opinions are now widely split between "we just completed a much-needed correction" to "this is the early phase of a primary bear market."



The Dow is "King," but the "Knights" (Transports and Utilities) are lagging far behind during this bear market rally.



The stock market is now close to an over-bought condition, but the economic news is still fairly good, and this causes analysts (who really should know better) to comment, "How can we possibly be entering a bear market when the economic picture looks so promising?" These economists may be ignorant of how the stock market works, but their optimistic words have the effect of keeping most people (including the fund managers) in stocks. Thus the area of confusion goes on.

I continue to remind my subscribers that the crucial issue here is NOT whether the CPI turns up or down next month, it's NOT whether the leading indicators blip up or down in July. No, the critical issue here is the direction of the primary trend of the stock market. And according to my studies, the primary trend of the market is in the process of turning DOWN.

"Russell, if you're correct," I'm asked, "how long will it take before the primary bear forces which you warn about become really obvious in both the economy and the stock market?"

My answer (am I being repetitive?) is that we are in the process of saying "good-bye" to a very old bull market, a 20-year bull market, a bull market that began back in 1974 -- and at the same time we are saying a reluctant "hello" to a newly confirmed bear market.

But remember this -- the bull's been master of the game for the past 20 years, and he's not going to up and die overnight. No, this tough old bull is fighting like the devil for his life. He's going to charge the bear, he's going to drive his horns into some short-sellers, and he's going to gore a number of people (and stocks and funds) before he finally keels over and dies.

And that's exactly what I think we've been seeing during much of April and all during May. Run through any chart book -- preferably a weekly or a monthly chart book for perspective. Peruse 30 or 40 pages, and you'll note the damage that has already been done to hundreds of stocks. For an example, I refer to the gambling (excuse me, gaming) group. I refer to this group because gambling is big-time, growing fast, and prominently in the news.

Glance at charts of the leading gambling stocks. All of them appear to be topping out. Too much competition? Over-regulation? Public running out of money or losing interest? Who knows, but the gambling story is good, Las Vegas is booming and Nevada is the

fastest growing state in the Union. So on the face of it, the picture appears bright. Yet the stocks have topped out. What's happening? It's the bear market in action, that's all you have to know.

However, I continue to caution that this market is still in no-man's land, with the majority of stocks milling around, bouncing up on Monday on some favorable news of the day, and then sinking on Tuesday on some analyst's unfavorable comments.

The real downward force of the bear has yet to assert itself, and it may be weeks or months or even until the end of the year before the primary bear trend emerges full force. In the meantime, expect erratic often meaningless news-oriented moves, erosion in selected stocks and groups, continued optimism on the part of many advisors, but overall -- confusion, frustration and losses.

Actually, it is in these "difficult" areas where my Primary Trend Index (PTI) can be particularly useful. The PTI measures the technical situation of the market each day, and it is the cumulative effect of these daily statistics that decides the trend of the PTI.

The PTI can be extremely helpful in measuring the quality of a rally or decline in the Averages. For instance, if the Dow rallies 100 points I watch to see whether the move is confirmed by impressive action in the PTI. If, on that 100 point rally, the PTI lags badly, it's obvious that the rally lacks strength and that it's just a matter of time before the market runs into trouble.

I also look for confirmation from the Advance-Decline ratio. After all, this ratio measures the advancing or declining tendencies of ALL the stocks on the NYSE. I liken the A-D ratio to the "crowd," and it's important to see whether the crowd follows the leader (the Dow, of course, is the leader).

INVESTMENT POSITION: The bear is trying to lull us to sleep (remember, bears can hibernate). But lest you forget, it's still a bear market, and Bruin's in no hurry to pull the plug.



Our position -- being defensive and being patient. Cash and gold items are the long-term preferred stance. Admittedly boring, but we're not in this business for excitement (at least I'm not); besides, before this bear market is over we'll have all the excitement we need.

I just got a "Low-Risk Buy" on (yes) the dollar, which is most interesting, particularly in view of the seemingly poor dollar fundamentals. The best thing going for the dollar is its low purchasing-power-parity, which means that the buck is undervalued in purchasing power in relation to other currencies. If you're traveling to Europe or Japan this summer you'll know what I mean (five dollar coffee, anyone?).

So sit with cash in T-bills or money market funds, let those shiny gold coins run through your fingers, watch the gold stocks back and fill, and, as Charles H. Dow put it, "Exercise the patience of ten men." (Today he would have said "ten men or women," besides, you and I know that women are more patient than men, anyway.)

HIGHS and LOWS: One of the best tests of internal strength or weakness during a bull or bear market is the study of the daily highs and lows (and I'm referring to daily new highs and new lows on the NYSE, based on the last 52-weeks).

During bull markets it's unusual to see the new 52-week highs dry up completely, even during downside corrections. In other words, the underlying bull trend is so strong during a primary bull market that even when the market is correcting, you're probably going to see 20, 30 or 40 new highs per day.

The reverse is true during a primary bear market. The accompanying chart illustrates this. Since February 16 we have

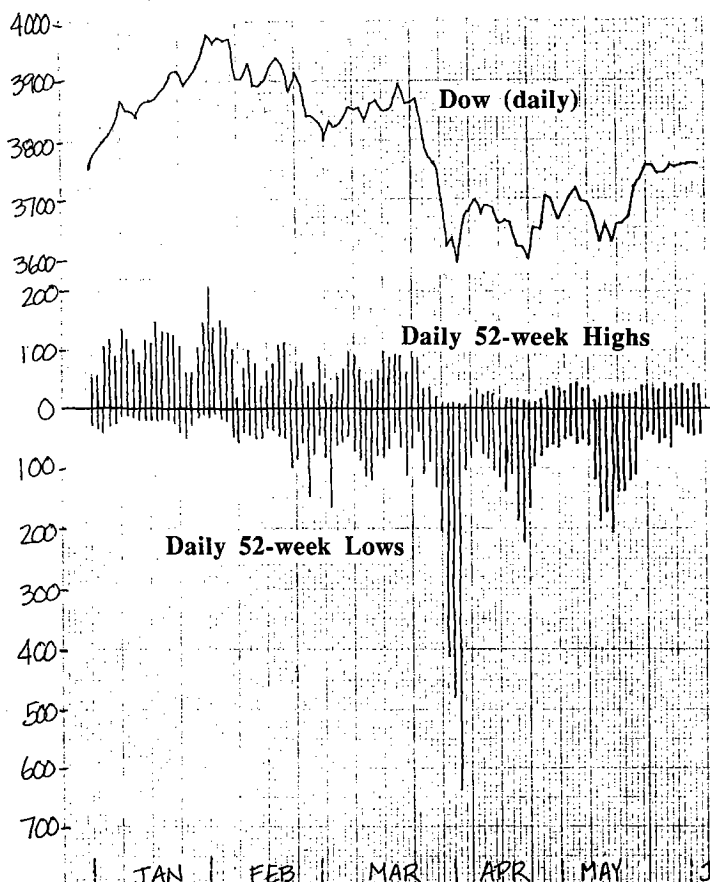
seen only five days in which there were less than 40 daily new 52-week lows (even on days when the Dow rallied strongly). Thus the conclusion, based on this chart, is that selling pressure has been constant ever since mid-February. Day after day, relentlessly, the bear has been pushing a flock of stocks to new 52-week lows.

Note that the peak of new lows occurred on April 4 -- 637 new 52-week lows appeared on that day. That total has not been surpassed since. This has led a few observers to state that "April 4 was the new lows' climax, and that low has not since been surpassed"; this, they claim is a bullish indication for the stock market.

That's an incorrect conclusion. As a bear market progresses you will see an initial surge in new lows (we saw that on April 4) and then the new lows will tail off as the market works lower. This contraction in new lows will give market optimists a false feeling of optimism. For in due time the market will experience another big break on the downside, and the new lows will explode, perhaps even to a higher total. "Damn," says the optimist who has been bottom-fishing, "I thought we had seen the worst." And the bear smiles, "Not yet you haven't," he says, "but be my guest -- keep trying."

I want to include the following section, courtesy of the very fine *Lowry's Reports* (631 US H'way One, N. Palm Beach, FL 33408). *Lowry's* has been following the market and the high-lows for decades and offers these very insightful comments:

"Several recent articles in the financial press have referred to the unusually large number of stocks registering New Lows in early-April as strong evidence that the market correction from the February highs may be over. They note that the 637 New Lows recorded on April 4 was consistent with the minimum number of New Lows found at or near important market bottoms such as '74, '78 and '80 to name a few. But in order to be historically consistent, the number of New Lows should be expressed as a percentage of the stocks traded on the NYSE. For example, during the 1974 decline, 661 New Lows were recorded on Sept. 13, 1974 (the actual low for most NYSE listed stocks). That represented 36.7% of the 1798 stocks traded on the Exchange on that day. In



contrast, the recent total of 637 New Lows on April 4 represented only 22.6% of the 2818 stocks then traded on the NYSE. Historically, readings of less than 30% have been commonplace and insignificant from a trend standpoint. The percentage of New Lows found at or near major market bottoms during the past 30 years has ranged from an extreme of 73.8% in June '62 to 34.9% near the 1990 bottom. The mean average reading at or near all of the major market bottoms since 1962 is 49.4%. In today's terms, that would equate to 1392 New Lows in a single day which, IF it occurred, would make the recent April 4th decline mild in comparison."

Russell comment: The above is extremely valuable and little known information, and should be borne in mind as this deceptive bear market evolves.

NOTES & QUOTES: The word among Democrat pols coming up for election is that "if you want a chance to win, you better disassociate yourself from Bill Clinton." The recent shocker -- Republican Ron Lewis defeated Dem Joe Prather in a Kentucky congressional election two weeks ago. Lewis won in a district in which Dems were registered 2 to 1 over Repubs, and where the Dems had been in power for 129 years. Said Bill Paxon (R-NY), head of the Republican Congressional Campaign Committee, "The Democrats are in a free fall without a parachute. There's a look of political fear on their faces."

Oh, Danny boy -- Danny, you should have grabbed the very advantageous plea bargain deal that Bennett arranged for you. Gad, now you've got to deal with a surprising 17 felonies, the severest being tampering with a juror. Shows what happens when one party rules both Houses forever. You Congressmen have immunized yourselves from a lot of the laws (including Social Security) that we poor slobs have to live by, and it looks like the slobs are just about fed up. Wait until you see the dirty water seep out as the Rostenkowski trial finally hits the headlines.



The gap between America's rich and poor continues to grow. From 1989 to '93 earnings for most American workers actually declined with the sharpest drop at the low end of the wage scale. A recent survey shows that average corporate CEOs earned 149 times the pay of the average factory worker. One reason for low worker wages -- lay offs and automation. The fact is that companies have learned to operate much more efficiently with far fewer workers, particularly with fewer low-skilled workers. This is putting extreme pressure on the unskilled work force, where sometimes hundreds of workers apply for four or five low-paying jobs.

I thought the following was worth quoting [from the always-interesting *Money-Forecast Letter* by Adrian Van Eck -- (800) 522-6187]: "LBJ thought he could lift the poor up into the middle class by giving them everything they wanted FREE. Instead, he caused a great increase in the number of poor. His programs -- almost 30 years later -- have resulted in the rediscovery of basic truths known 300 years ago by the Puritans who set down America's productive foundation. America has learned again that there are people who will CHOOSE to stay idle, if given the opportunity. They will think up excuses for their idleness. It will become a way of life. First for

them. Then for their children. And now for their grandchildren. *This is starting to frighten some of the very people who originally believed in the Great Society.* They are seeing 29-year old grandmothers . . . 14-year old mothers, crack babies with no nervous systems and little ability to concentrate, and few chances of making a living in the world. The early idealism has turned to anger . . . even to disgust."

Can a nation create wealth at will? No, but it can create money at will. Take the example of Croatia. On May 30 President Tudjman revived the "kuna," a currency used during 1941-45 when Croatia was a Nazi puppet state. Despite protests that the kuna has Nazi associations, Tudjman insists that "the kuna has been the currency since the 11th century." So the kuna replaces the Croatian dinar, and a brand new money has been legislated into existence. It will be printed in Germany, and the new kuna will be exchangeable with the dinar at the rate of 1000 to 1 until the end of 1994 without being devalued. So it goes in the world of paper money.

California may be broke (the deficit this year will be about \$4 billion), but that doesn't stop the pols from taking theirs. The California legislature just gave themselves raises of from 76% to 112%. Nice going guys and gals -- nothing like a dose of good, old-fashioned greed.

Shop-Drop: A year ago people believed Barry Diller could walk on water. Now they're wondering whether he can even swim. His QVC has declined from a high of 73 to a recent low around 30. Diller failed in his Paramount takeover, and now rumors (strictly rumors) are that he'd like a shot at Time Warner. As for QVC, the whole home shopping thing has slowed down and QVC's revenues and earnings have also been slowing. A drain has been start-up expenses for Diller's new up-scale Q2 channel.

When you compare gas taxes in various nations, you realize what a bargain we've got here in the good ol' USA. Here's a list of the pump prices and the tax as a percentage of the gas price. Example, in France 80% of the price of gas is from taxes. In Germany 74% of your gas price is from taxes. Can you imagine the screaming the great US consumption society would send up if we even doubled the tax on gas (of course, the pols would love it)?

	Price	Tax	Tax as % of price
Australia	1.80	1.01	56
Belgium	3.28	2.38	73
Brazil	2.16	0.79	37
Britain	2.89	2.04	71
Canada	1.36	0.72	53
Denmark	2.84	1.86	65
France	3.44	2.74	80
Germany	3.05	2.26	74
Italy	3.46	2.55	74
Japan	4.43	2.07	47
Netherlands	3.92	2.85	75
Norway	3.85	2.75	71
S. Korea	2.85	1.79	63
Thailand	1.16	0.52	45
U.S.	1.05	0.41	39

I do a lot of complaining, and last week a subscriber wrote to say, "OK, Russell, if you were President, what would you do first?" A fair question, and here's my answer. (1) I would end the great Ponzi scheme which we call Social Security, and opt for a private system based on fully-funded, tax-free pension plans. (2) I'd get rid of the whole scandalous income tax system, jettison the IRS, and institute a national sales tax instead. This would encourage savings and discourage consumption. (3) I would abolish the Federal Reserve System and put the dollar back on a 100% gold-backed basis. This would end inflation and make the dollar the most-wanted currency in the world. (4) I would privatize that absurdly inefficient, deficit-ridden monster we call the Post Office. (5) I'm still working on what I'd do with the crazy Welfare system. But believe me, there would be changes.

What are the chances of any of the above coming to pass? Answer: right now -- zero. Ultimately, they may all come to pass, but only after the current system goes into crisis.

If interest rates continue to rise, some of the big (I mean huge) casualties will be the banks, insurance companies and mutual funds that hold most of the \$1.5 trillion in mortgage-backed securities. During the long bull market in bonds home owners continually refinanced their homes at lower and lower interest rates. Then, when interest rates started up the squeeze was on and the first ones to be hit were some of the hedge funds. But the story is far from over, and if rates continue to rise the result will be kill-time for holders of mortgage-backed securities. The Fed obviously knows this, and they are aware of the consequence if interest rates continue to advance. What would you do if you were Alan Greenspan? I think I'd get out while I was ahead.

Marc Faber of Hong Kong notes that some of the greatest buys of the century were in German securities during the early 1920s, when Germany was devastated by hyperinflation. He notes that at the time stocks were so cheap that you could have bought the whole Daimler Benz company for the equivalent price of 327 of its own cars. Faber believes that Russia may be the bargain counter today. He notes that by the end of June mass privatization will have put 70% of Russian industry into private hands. Russian assets, states Faber, are dirt cheap.

According to the London *Financial Times*, "Russia is in a deep crisis as their output plunges by 25%. The Russian Ministry of the Economy has warned the government that they risk 'a social explosion'."

Have you used E-mail yet? We have. Example: Lynn Hunter, who works here, sent an E-mail letter to her brother, a professor at Tufts in Boston. She got an E-mail reply from brother within 20 minutes. And I ask myself, how can the US post office survive in the face of the coming E-mail and FAX explosion? In the face of the reality of FAX and E-mail, my opinion is that the 700,000 employees of the dinosaur US Post Office are at risk. I honestly don't see how the PO is going to survive.

While I'm at it, here's my vision of the future -- a large flat-screen viewer in every American home. The screen will be the viewer for the PC computer, and everything will go through that screen -- movies, restaurant menus, stock quotes, museum openings, airline rates, encyclopedias, road maps, newspapers, magazines, you name it, if it's art or information, it will appear on your computer screen. Say good bye to TV as we know it. Furthermore, it wouldn't surprise me if the "information highway" doesn't end up wireless rather than via fiber optics.

A few people have written to ask how Japan (with the yen doubling in value against the dollar since 1985) can continue to run huge trade surpluses with the US. Here's how it works. The Japanese actually live on a series of small islands, and they import a huge percentage of their raw material needs. The stronger yen allows the Japanese to buy oil, lumber, copper, etc. at bargain prices in terms of Japanese costs. For instance, oil is always sold in terms of dollars. This means that since 1985 the cost of oil to the Japanese has been cut in half. So you see that raw materials costs in Japan have dropped precipitously; this combined with efficient manufacturing methods is how the Japanese have competed so successfully.

Back in the very early '60s I used to ride BMW motorcycles. At that time BMW was almost broke, their autos were not big sellers, and their bikes were produced in an ancient brick building. In fact, in 1959 BMW went hat in hand to Daimler-Benz, asking them to take over the company. Daimler was not interested. But Herbert Quandt (a major stock holder in Daimler) thought differently, and he bought a huge chunk of BMW stock for practically nothing. Under Quandt's care, BMW thrived, then boomed. It is thought that Quandt's widow and his family now own 60% of BMW. Furthermore, BMW is now the most prosperous auto company in Germany (the only German auto company to make money last year). But blushingly, I must confess that with it all, I prefer Mercedes.

Bruce Willis, Demi Moore, Stallone and Schwarzenegger are doing well with their Planet Hollywood theme restaurants (which directly

compete with the ubiquitous Hard Rock Cafes). The quartet is opening 10 more Planets. In London a few weeks ago Willis was present for the opening of the latest Planet Hollywood. Suddenly a happy Willis announced that he would buy dinner for all those present. The place was packed, and without batting an eye Willis paid the bill. It came to just over \$20,000. Moral -- it's nice to be rich and famous.

I went to LA last week to see a preview of my son-in-law Vincent Van Patten's new movie, "The Break." The movie was excellent, exciting, and the final scene left me white-knuckled. At the preview I talked to Vince's friend, a trauma surgeon now working in the emergency room of a large Florida hospital. The doc told me that he sometimes treats up to nine gun-shot wounds in a single night. He told me that blacks are shooting each other with amazing impunity, often over a minor argument. He told me some of the gun-shot victims have been shot two and three times previously.

I continue to feel that the black problem in America is daunting. The worst part is that many blacks are placing themselves outside the system. But the fact is that the US runs on "the system" (i.e., higher education, laws, lawyers, Wall Street, computers, banks, Internet, etc.), not on the underground or the underclass. Thomas Sowell (he's a black columnist for *Forbes*) put the following question to a class at (black) Howard University -- what would happen to a black child born in the ghetto with an intelligence identical to Einstein's? "Not one person in that room thought that this child would grow up to be another Einstein. If he were born to a teenage mother in a gang-infested area, he might be lucky to grow up at all -- and he might well be one of those conditioned to believe that putting his efforts into academic work would be 'acting white'." **Russell comment:** The daunting problem is that many blacks now believe that getting an education or working within "the system" is "acting like Whitey." Talk about a racial "catch 22" -- go for an education and you're ostracized if not worse; skip the education and you stay in the ghetto.

From a report just received from Christie's, the big auction house. "Strong prices were seen for historical jade period jewelry. The Wellington Koo necklace sold for \$900,000. This was the highest price achieved in Hong Kong this Spring auction season and is one of the strongest prices paid for Jadeite jewelry in recent years . . . Asia is potentially the most important area of growth for our department and our expanded jewelry team now looks forward to a full program of sales in this region, which will include Hong Kong, Singapore and Taipei." **Russell comment:** Interesting, no?

Today all the kids (including my own) listen to MTV. To me, it's mostly noise. I can't take the rap, and most of the heavy metal is painful to my ears. I'm willing to admit that I'm "out of it," and that my kids are hearing something too esoteric for my "untrained" ears. But no, c'mon, today's "music" is the worst in history. I hesitate to even call it music. Now a new book is out, "Hole in Our Soul; The Loss of Beauty and Meaning in American Popular Music," by Martha Bayles. She states that today's artists don't come under attack for fear of the cry of censorship. Continues Bayles, "Today's cult of obscenity, brutality and sonic abuse" is shaping the dominant youth culture -- selling nihilism, dehumanized sex, ugly excess and unfeeling cruelty. It functions to stir up anger among young males, and Bayles calls the spread of this stuff a social problem. I agree -- try as I might, I can't get anything pleasant, interesting, or even exciting out of today's music. It's angry, boring, ugly, violent and totally forgettable.

Writing in the *Washington Post*, veteran columnist David Broder notes that the current economic statistics are pretty good, "but if everything is so good, then why do so many people . . . feel so bad?" Broder notes that Clinton is also feeling bad, and he recently whined, "I've been subject to more assault than any previous president" (which Broder says is bunk, since every president has taken his share of verbal abuse). Broder continues, "It's not just Clinton who's in a pout, the whole country has a sour puss. In a poll last month, 69% of the people said that the country was seriously on the wrong track."

Scientific American (great magazine) for June has a fascinating article on ethnobotanical science or the search for drugs from plants. The article notes that dozens of drugs have come from plants -- aspirin, codeine, ipecac, quinine, reserpine, scopolamine, etc. Of 265,000 flowering plants on earth, less than one-half of 1% have been studied for possible new drugs. Interestingly, researchers often go to primitive native "healers" for hints of where new plant-drugs may reside. Some of these healers (many living in the rain forests) have been using plant-drugs successfully for generations.

Dagwood's boss, Mr. Dithers, has his own prehistoric way of dealing with forward-looking employees, as noted below (forgive me, I've always loved the Blondie cartoon strips).

BLONDIE By Dean Young and Stan Drake



My old schoolmate, Donald Morris, puts out a syndicated weekly News and Analysis Comment. An excerpt from his latest: "The foundation of drug Demand (and thus much of the violence in America) is that American citizens pay \$40 billion a year for narcotics. Most of that money, moreover, leaves the country and can only return to the economy after it is laundered. The economic repercussions of this uncontrolled, untaxed trade are almost as serious as the assorted social evils of the narcotics. The unregulated tidal flow of funds makes hash of many of the fundamental fiscal indices on which government planning rests (Marijuana, for example, is the leading cash crop in seven states) . . . The lucrative farms and factories remain in business, the overwhelming majority of the commodities reach the customers, and personnel attrition, from the notorious CEOs to the armies of street dealers and lookouts, is replaced by eager recruits from the inexhaustible pool hoping to share in the profits . . . More and more assets we can ill afford are thrown into, or promised for, the fight against Supply; little or nothing is done to reduce Demand. Other nations also have drug problems -- but by assorted approaches to legalization, they have managed to confine drugs to a medical, not a police, problem . . . As Jesse Jackson and scores of others have pointed out, building more prisons isn't going to reduce crime or violence. Reducing \$300 a day habits to \$30 or even \$3, will vastly reduce crime and violence -- it won't eliminate it, but it will reduce it to manageable proportions. A junkie with a monkey on his back has no choice but to mount the public's back. Pay for the monkey on his back, and he'll get off yours." (*The Trident Syndicate*, PO Box 19909, Houston, TX, 77224.)

I watched two of the D-day/Normandy TV shows, and they brought back dark memories of war. The sounds, the chaos, the German 88s firing into the sky, (how we dreaded them), the dead and dying, the fear, the smell of death, they still have me breaking out in an armchair sweat. I just got the June issue of *Crosshairs*, the official publication of the WWII Bombardiers. Strange, but I've

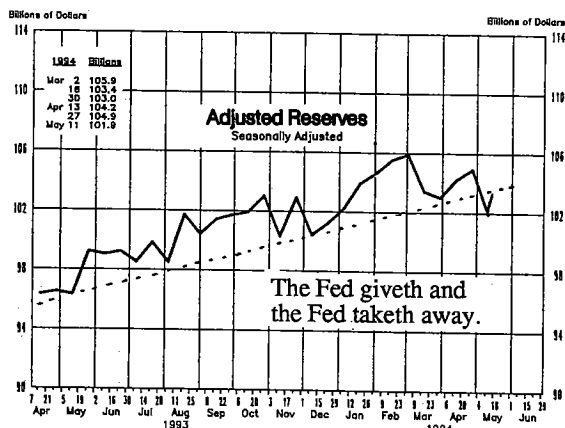
never heard from or run into any of the guys from my B-25 crew. I estimate that 25,000 people read these Letters, so here goes -- if any of you out there were members of the 446th Bomb Group, 12th Air Force, drop a line, I'd love to hear from you.

PRECIOUS METALS: Leonard Kaplan is a long-time precious metals trader with LA-based Imperial Bank. Every commodity has its own characteristic action, and here's what Kaplan says about the precious metals. *"The gold market is back and fill like no other market I've ever seen. You can generally do well selling rallies and buying dips because the market tends to back and fill . . . you rarely see gold rally, or close higher, more than three days in a row. Silver is exactly the opposite -- like a runaway train. You never stand in front of it."*

Russell comment: I agree, although in 1979, during the late stages of that gold bull market, we did see many successive days when gold would surge. However, that was a rarity. But then Kaplan adds, *"Trading is the ultimate game, because they change the rules every hour and don't tell you. I feel lucky to have been in this industry so long and still maintain some sanity, if not much hair."*

It is clear to me that the Fed and the Treasury would "like" gold pegged at 350. In fact, economist Lawrence Kudler (letter to the WSJ, May 31) advocates that the Fed use 350 dollar gold as a barometric center-point. He states that the Fed should increase bank reserves if gold falls below 350 and reduce reserves if gold climbs above 350.

With gold now in the 380-390 zone, the Fed must be worried about the picture, particularly with the bull trend in both commodities and raw materials. The fact is that the Fed is now (finally) cutting back on reserves as this chart from the St. Louis Fed indicates.



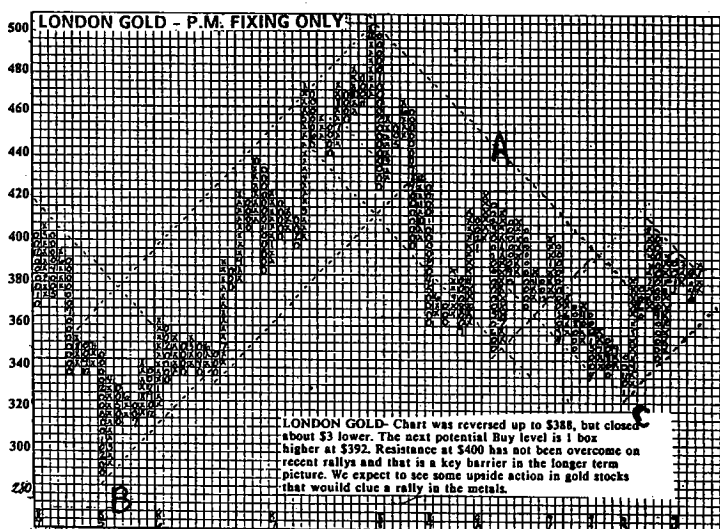
However, the fact is that the effects of monetary policy kick in very far ahead (sometimes as long as three years ahead) of Fed action. A further fact is that the Fed has increased the monetary base 42% over the past four years. In other words, the groundwork has already been laid for rising inflation. And the inflation statistics are just now beginning to surface.

What about gold and gold stocks? I have said repeatedly that the lows are in place for the whole gold universe. And gold items have been moving up. But the move has been confusing, erratic, subject to dozens of rumors, news events, and yes, even outright threats from the Fed.

Many months ago I warned subscribers that this would be the scenario for a while. But somewhere ahead I am just as convinced that the real power of the primary bull trend will exert itself on gold. At that time we will see the metals (gold, silver, platinum) move up and probably make as much upside progress in a few weeks as they did over the last year or so.

This point & figure chart of gold shows the story in concentrated form. Note that all the recent action has taken place above the long declining trendline marked A on the chart. A London gold fix at 392 would represent a minor upside breakout, but 392 would also put gold in position to attack the psychological barrier of 400.

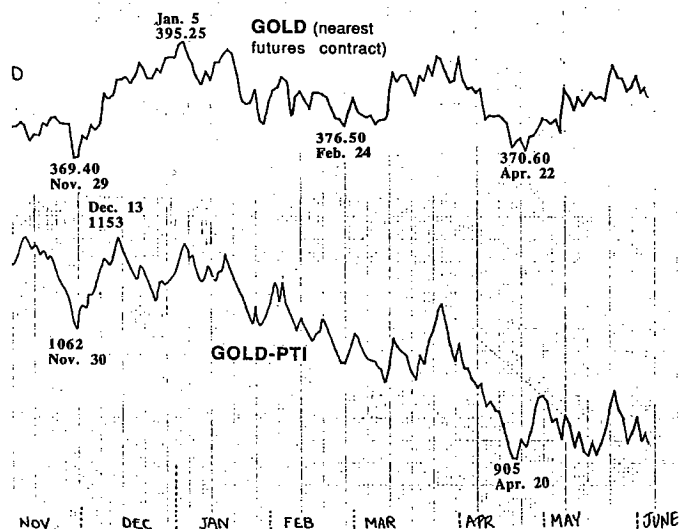
Note that the final bear market bottom for gold occurred on Feb. 5, 1985 at 284.25 (point B on the chart). Gold then rallied to 499.75 in December of '87, followed by an extended correction down to 326.10 struck on March 10, '93 -- point C. (Chart courtesy of Chartcraft, PO Box 2046, New Rochelle, NY 10801).



I can't prove it, but it does seem more than coincidence that every time gold nears 390, "somebody" hits it, knocking it down into the lower 380s. Are the Fed or the Treasury behind this? I wouldn't doubt it. What's impressive, however, is that gold keeps coming back to attack the 390 area.

My Gold and Gold-PTI chart needs little explanation. Gold has moved erratically up from its April 22 low of 370.60. The G-PTI, having struck a low of 905 on Apr. 20, has been struggling, but the Apr. 20 low has held. An advance by the G-PTI above 1005 would be an important bullish achievement. Meanwhile, we watch and wait.

NEXT MAILING: June 22, 1994



LATE NOTES: A respite -- remember, I just got a "Low Risk Buy" on the dollar, which is a plus for both bonds and stocks. Every move (up or down) in the stock market is eventually corrected, and the stock market is in the process of correcting the initial January-to-April bear leg.

The Dow, the market leader, has still not recovered as much as half of its January-April losses, and the Transports and Utilities are lagging far behind. Meanwhile, investors are hanging onto every tid-bit of news -- as if the news of the day will change the direction of the great primary trend of the market.

Study the A-D ratio on the page 2 chart -- the A-D is telling us that the majority of stocks has still not participated in this rally. What do we do? Remember last year's film hit, "The Crying Game." We're patient, and we'll play "The Waiting Game."